



Non-Wage Withholding P.L. 109-222 § 511

- *Requires 3 percent federal income tax withholding on vendor payments*
- *Takes effect January 1, 2011*
- *Does not apply to the private sector; only applies to federal, state and local governments that spend at least \$100 million per year on products and services*
- *Unfunded mandate slipped into final version of tax bill without hearing or consultation*
- *Costs include system programming, staffing, reporting and price increases from vendors*

County News

National Association of Counties
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Counties: Uncle Sam wants you to collect federal taxes

By ALYSOUN McLAUGHLIN
ASSOCIATE LEGISLATIVE DIRECTOR

The federal government is conscripting your county personnel into serving as federal tax collectors.

A new law may soon require your county to withhold 3 percent of nearly every payment to a vendor or contractor and send it to the federal government. According to Miriam Singer, director of procurement for Miami-Dade County, the new requirement — which applies to county purchases of everything from plumbing services to paper clips — amounts to “taxing local governments to subsidize the federal budget.”

That is, of course, the point of this new requirement. The overall price tag on the tax bill signed into law in May was capped for procedural reasons at \$70 billion. The House of Representatives insisted on including a \$50 billion extension of the current tax rate on capital gains and dividends while the Senate insisted including a \$30 billion “patch” on the Alternative Minimum Tax. To pay for including both in the final bill, conferees slipped a package of revenue raisers including this provision into the bill just prior to House and Senate passage, leaving no time for organized opposition.

Indeed, the Joint Committee on Taxation believes that counties, cities, states and federal procurement officers will collect more than \$6 billion in taxes that government contractors and vendors would not otherwise have paid to the IRS in FY11.

Members of Congress have discovered that thousands of Pentagon contractors owe more than \$3 billion in taxes to the federal government. Rather than simply enforcing the law against these contractors or imposing a new withholding requirement on contracts with the federal government, this new requirement will apply to states



and any local government that spends more than \$100 million per year on purchases of goods and services. Smaller cities and counties are exempt.

Counties will receive no compensation for providing this service to the federal government but will be required to spend millions to upgrade accounting software and hire staff to do the job of IRS auditors.

Christine Cohen, auditor-controller for Ventura County, Calif., said it is too soon to assess the dollar impact but, “I am sure that with the system programming changes, reporting requirements, staffing allocations and new deadlines, we would also be faced with price increases from vendors, adding to the cost of government projects.”

Since the requirement only applies to the public sector — not private purchasers — Cohen is not alone in her concern that this new law will place counties at a competitive disadvantage in purchasing products and services. According to budget director Dawn Jindrich, Linn County, Iowa “already [has] trouble getting contractors to bid on some of our projects because of the additional requirements related to government contracts. This will make it even more difficult to do competitive bidding.” Jindrich also questioned the logic of the requirement since many of the county’s



contractors are Subchapter S corporations that are already required to pay quarterly estimated taxes.

Tim Firestine, finance director for Montgomery County, Md. pointed out that counties already send a form 1099 to the IRS for payments in excess of \$600 and questions why that is insufficient for the IRS to track down any vendor that does not pay their taxes.

Gary Malmgren, chief accountant for Contra Costa County, Calif. said a number of unanswered questions remain. For example, the law does not spell out how the county will report withheld amounts to either payees or the IRS, how often payments must be sent, or what penalties might apply to late payments or inaccurate reporting. He also ques-

tioned how it might apply to payments made through a third-party credit card bank.

Congressional staff familiar with the conference negotiations indicate that members of Congress intentionally applied the requirement to credit card payments to avoid creating a loophole, and for the same reason did not exempt small transactions from the requirement. However, they suggest that counties, cities and states might be able to work with the Treasury Department to determine a threshold to ease administrability without creating a loophole.

Congress did exempt certain payments from the law — specifically payments for interest and real property, payments to other governments, nonprofit entities or government employees, and payments in

connection with a means-tested public assistance program or pursuant to a classified or confidential contract.

These exemptions may drive up costs, however, precluding automatic transaction coding and requiring county personnel to review individual transactions to determine whether they classify.

Sen. Larry Craig (R-Idaho) has introduced legislation to repeal this unfunded mandate on state and local governments as well as the withholding requirement for federal government vendors and contractors. NACo is working with his staff and is exploring options for repealing or mitigating the costs of this unfunded federal mandate.

National Association of Counties

NACo Legislative Department — Edwin S. Rosado, Director

Repeal New Non-Wage Withholding Requirement

Issue: New requirement that counties that spend more than \$100 million annually on products and services serve as tax collectors for the federal government by withholding and remitting 3% of most payments for products and services for federal income tax purposes.

NACo policy: NACo opposes unfunded mandates on counties and demands meaningful involvement by county officials in federal decisionmaking.

Action needed: County officials should urge immediate repeal of the unfunded mandate in Section 511 of P.L. 109-222. County officials should provide as much specific information as possible on the anticipated cost.

Background: SH.R. 4297, the "Tax Increase Prevention and Reconciliation Act of 2006", was signed into law as P.L. 109-222 on May 17, 2006. Major provisions of the law extended the 15% tax rate on capital gains and dividends and prevented an increase in the number of taxpayers subject to the Alternative Minimum Tax. Section 511 of the law creates a new withholding mechanism for payments to government vendors and contractors.

Section 511 did not appear in either the original House or Senate version, but was inserted by a conference committee seeking to offset the cost of tax cuts sought by both the House and the Senate. The provision will raise \$7 billion for the federal government between 2011 and 2015 by requiring any jurisdiction that spends more than \$100 million per year on goods and services to withhold 3% of most payments to vendors and contractors. The requirement only applies to states and local governments, not the private sector.

Withholding will be required, beginning January 1, 2011, for any payment - regardless of the amount or form of the transaction - to purchase any product or service other than interest or real property. No vendor or contractor is exempt except other governments or nonprofit entities and government employees. Payments made in connection with a public assistance program based upon need or income or pursuant to a classified or confidential contract are exempt. Further details will be determined by the U.S. Department of the Treasury.

The Congressional Budget Office and the Joint Committee on Taxation have indicated that the costs of this intergovernmental mandate exceed the threshold specified in the Unfunded Mandates Reform Act (\$62 million per year in 2006, adjusted annually for inflation). County officials indicate that this requirement will be extremely expensive to implement. In many cases it will require programming changes to financial and accounting systems and the hiring of additional staff. Many county officials are also concerned that it will discourage contractors from bidding on government products and increase pricing.

This unfunded mandate is particularly egregious because it was added to the final version of legislation without any consultation with state and local government officials or their national organizations.

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NACo FACT SHEET

Government Withholding Relief Coalition

July 11, 2006

The Honorable Larry Craig
United States Senate
Washington, D.C. 20510

Dear Senator Craig:

The *Government Withholding Relief Coalition* and its member organizations listed below strongly support your legislation, S. 2821, the Withholding Tax Relief Act of 2006. This important legislation would repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222). Section 511 is a sweeping new requirement mandating that federal, state, and local governments withhold 3-percent from payments for goods and services. This new tax withholding requirement affects all government contracts as well as any payment to any person for a service or product provided to a government entity.

We are deeply concerned about the impact and the unintended consequences of this provision on all companies that receive contracts or other forms of payment from the government. Among other concerns, the withholding is based on revenues from government payments with no relationship to a companies' taxable income and will impinge on company cash flows needed for day-to-day operations. In addition, the costs to governments at all levels to administer the program will be substantial and the process exceedingly complicated to implement.

The *Government Withholding Relief Coalition* and its member organizations appreciate your leadership on the effort to repeal the withholding requirement and look forward to assisting you on this issue. We are committed to working with Congress to rescind this harmful provision.

Sincerely,

Government Withholding Relief Coalition

- Aerospace Industries Association
- Air Transport Association
- American Congress on Surveying and Mapping
- American Council of Engineering Companies
- American Institute of Architects
- American Road & Transportation Builders Association
- American Shipbuilding Association
- Associated Builders and Contractors
- Associated General Contractors of America

